140TH ANNIVERSARY
THE NATIONAL CITY BANK OF NEW YORK
EST. 1812
1812 - 1952

Monthly Letter on
Economic Conditions
Government Finance

New York, February, 1952

General Business Conditions

THE business situation has shown little change either in fact or sentiment during January. The principal news of the month has come from Washington, in the transmission to the Congress of the federal budget and the President's economic report. The budget, which is described in a subsequent article in this Letter, sets expenditures for fiscal 1953 at $85 billion. The economic report indicates an increase of close to $20 billion in government purchases of goods and services in the calendar year 1952. These are stupendous figures, with inflationary implications that have deeply disturbed the country. Nevertheless, the day-to-day news contains almost no evidence of fears of shortages in consumers' goods or of markedly higher prices, through which further inflation would be expected to show itself. Trade has continued on the sluggish side, and commodity prices on the average have moved a little lower.

In short, what more and more observers are calling "a state of precarious balance" persists. People abhor the waste and extravagance which all know must go with enormous spending, and they fear the ultimate consequences in the form of deficit financing and further depreciation of the dollar. On the other hand, they wonder whether expenditures will actually come up to the estimates, and they are continuously impressed by the remarkable demonstration the industries have given of their ability to satisfy both defense needs and consumers' wants.

CONTENTS

Influences Moderating Inflation Fears

The impact of the spending figures on sentiment is further reduced by the evidence that the defense program is being stretched out, which means that the peak of its demand will come later than previously estimated. Mr. Wilson, the Director of Defense Mobilization, said at a dinner in New York January 28 that the peak of nearly $65 billion, annual rate, will be reached in the first quarter of 1953, the latest date so far given. The rate of increase in 1952 thus will be somewhat slowed. During the month rescheduling of deliveries and cancellation of certain projects have been reported. This represents revision of earlier schedules — now shown to have been unrealistic in view of the machine tool bottleneck and other production problems — and also delay in freezing designs, which is understandable in light of the production delays as well as the danger of obsolescence.

Another consideration which moderates inflationary fears is the extent to which defense demands have been anticipated and prepared for by the producers concerned. The rise in their inventories shows that they have been taking in more materials than they have been delivering in finished goods. Thus the impact of the future increase in deliveries, in part, is already felt.

Finally, consumer goods industries in the main do not yet seem ready to move ahead. In the merchandise trades the lack of any pronounced pickup, which some hoped would appear with the opening of spring lines in the wholesale markets, has been a disappointment. Great

progress has been made in reducing retail and wholesale stocks, and almost everyone expects that retail sales will run ahead of last year after the first quarter, when comparisons will no longer be with the scare buying of early 1951. But merchants go on the assumption that there will be ample goods for quick delivery. Like their customers, they are shopping for values. Their commitments are low, and they must come to the markets for current needs, but they are not buying enough to absorb mill stocks of textiles and give the mills the lift for which they are looking.

Consumers' durable goods manufacturers also find demand slow and distributors well stocked. Their chief problem, however, is shortage of materials and limitation of operations by government order. The automobile industry, which in the first quarter has a passenger car quota of 930,000 minimum and 1,006,000 maximum, in the second quarter will be cut down to 800,000 minimum, with permission to go higher if it can do so by "scrambling" and by substituting for scarce materials. Allotments of scarce metals for household durable items will be in general 10 per cent below the first quarter. Obviously these industries will not be giving normal support to the situation.

Overall Activity Stable

In overall terms, the soft spots and the restraining factors above mentioned are not exerting a net depressing influence, but by offsetting defense and capital goods expansion they are keeping aggregate activity on an even keel and the price trend roughly sideways. The index of industrial production has held steady for some months, only a few points below the record peacetime high, despite the soft spots. Employment in the aggregate is full or overfull, despite the problems of Detroit and a few other areas. It is deplorable that good workers are idle while defense production is slowed in other places by labor shortages, and all that can properly be done by the planning and procurement agencies to route defense work where employment is needed should be done. However, the significant fact is that the metals which the automobile workers usually consume are now being consumed elsewhere. Except for soft goods and a few other items, the productive organization as a whole is operating at about as high a rate as the supply of metals and machine tools permits.

In the key areas of defense and capital goods the demands on the economy in 1952 will be greater than in 1951, and that is likely to be true of the aggregate of all demands. In addition to the estimated increase of $20 billion, or nearly that, in government purchases of goods and services, business expenditures for plant and equipment are now expected to be larger also. Following the regular survey made some weeks ago by the Department of Commerce and the S.E.C., which estimated that these expenditures in the first quarter of 1952 would be 18 per cent above a year earlier, the McGraw-Hill organization has now completed a survey of programs for the whole year 1952 which indicates an increase of 13 per cent over 1951.

In the aggregate of economic activity these two demands – from the government and for the expansion and improvement of private business – can be expected to be controlling. Evidently they will rise more than the other elements in the national output are likely to decline, even though other types of construction are almost certain to drop considerably and inventory accumulation is expected by many to cease entirely, with consequent elimination of demand for that purpose.

The lessons of history and experience should persuade business men that while activity and employment are maintained in the industries supplying defense and capital goods requirements, the people of the country can be expected to have plenty of work to do and to enjoy high purchasing power. Virtually all responsible estimates of the 1952 outlook agree that consumer expenditures on goods and services should be higher, for the year as a whole and especially for the latter part, than in 1951. From this viewpoint bearish opinions based on the soft goods situation, which has been under correction for some months, look belated.

$14 Billion "In the Red"

The outstanding fact revealed by the President's budget message to Congress last month is the abandonment by the Administration of the sound principle of meeting the cost of the defense program on a pay-as-we-go basis, and acceptance of the policy of deficit financing. With expenditures for the fiscal year ending June 30, 1953 estimated at $85.4 billion and revenues at $71 billion, the indicated deficit is $14.4 billion. This compares with an estimated deficit of $8.2 billion for the current fiscal year, and an actual surplus of $3.5 billion for fiscal '51.

This prospect is, as the President says, "a cause for grave concern." In the budget message he states:

> When we embarked on the defense program to keep our country strong, I stated that sound financial policy required us to pay for the increased defense costs by current taxation, and that we should avoid adding substantially to the public debt. This policy is important to

the preservation of the financial strength of our Government, to the success of the stabilization program, and to the sharing of defense costs fairly.

The President blames Congress for its "inadequate tax program" last year, and proposes $5 billion in new taxes, mainly through the closing of "loopholes". Such taxes, even if enacted (which is doubtful in view of expressions in Congress), would still fail to cover the indicated deficit by a wide margin. That the President did not ask for more is tacit recognition that taxes have already about reached the limit Congress is willing to vote, barring all-out war.

In short, the program, if carried through as projected, means imperilling the objectives named above by surrender of our strongest bulwark against inflation – the pay-as-we-go policy – and injection of an inflationary element of great magnitude into a situation already fraught with inflationary potentialities.

United States Government Budget Receipts, Expenditures, and Public Debt, 1914-1953

(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Total Net Expenditures	Net Surplus or Deficit	Public Debt June 30
1914	$ 735	$ 735	$ 0	$ 1,188
1917	1,124	1,978	— 853	2,976
1918	3,665	12,697	— 9,032	12,244
1919	5,152	18,515	—13,363	25,482
1920	6,995	6,403	+ 291	24,299
1925	3,780	3,063	+ 717	20,516
1930	4,178	3,440	+ 738	16,185
1932	2,006	4,741	— 2,735	19,487
1935	3,800	6,592	— 2,791	28,701
1940	5,296	9,206	— 3,910	42,968
1941	7,227	13,387	— 6,159	48,961
1942	12,696	34,187	—21,490	72,422
1943	22,201	79,622	—57,420	136,696
1944	43,892	95,315	—51,423	201,003
1945	44,762	98,703	—53,941	258,682
1946	40,027	60,703	—20,676	269,422
1947	40,043	39,289	+ 754	258,286
1948	42,211	33,791	+ 8,419	252,292
1949	38,246	40,057	— 1,811	252,770
1950	37,045	40,156	— 3,111	257,357
1951	48,143	44,633	+ 3,510	255,222
1952 Est.	62,680	70,881	— 8,201	260,222
1953 Est.*	70,998	85,444	—14,446	274,922

* Excluding proposed new taxes.

As shown by the table, the estimated expenditures for next year of $85.4 billion were exceeded only in 1944 and 1945, peak years of World War II. Yet, as the President points out, "despite its size, this is not a budget for all-out mobilization." The public debt is estimated to rise by the end of fiscal '53 to its statutory limit of $275 billion.

The President expresses the "hope" that we may be able to reduce budget expenditures after the fiscal year 1954 "when most of the planned military expansion will have been completed." Skeptics may consider this optimistic in view of the well-known tendency for government functions to multiply, and in view also of the references in the budget message to the many programs being held back in deference to defense requirements, presumably to blossom forth when the emergency is over. However that may be, the country in the meantime, barring some vigorous budget-cutting by Congress, will be subjected to a new dose of deficit spending, with all its inflationary implications.

Where the Money Goes

The President defends his budget by pointing out that more than three-fourths of the total expenditures are for "major national security programs" – military services, international security and foreign relations, development of atomic energy, promotion of defense production and economic stabilization, civil defense, and merchant marine activities. These programs, he says, not only dominate the budget but also account for practically all of the increase in total budget expenditures since the attack on Korea.

The next table from the budget message shows expenditures classified by "major national security programs" and "all other".

U. S. Budget Expenditures

(Fiscal Years. In Billions of Dollars.)

	1950 Actual	1951 Actual	1952 Est.	1953 Est.	% Change 1950-53
Expenditures for major national security programs	$17.8	$26.4	$49.7	$65.1	+266
Expenditures for all other government programs	22.3	18.2	21.2	20.3	— 9
Total budget expenditures	$40.1	$44.6	$70.9	$85.4	+113

Mr. Truman calls attention to the fact that, in the table, expenditures in the "all other" classification have declined 9 per cent since the fiscal year 1950, before Korea, observing that "this decline has occurred during the period when the costs of goods and services which the Government buys are rising."

Budget Cuts Inadequate

The economy measures listed by the President are all to the good as far as they go, but do not go far enough. The budget remains too big, if resort to deficit financing and new inflationary pressures is to be avoided.

It is of course true, as the President states in his economic report, that a budget balanced by "sacrificing" the defense program and putting the balance of world power in the hands of the Kremlin would be false economy. But that is not the issue. The real question is one of judgment in relating the size and tempo of rearmament to the country's economic capabilities, and of how much we can save by cutting waste in the military expenditures, and by paring down other programs that we could postpone or do without.

All three of the President's messages – that on the State of the Union, the economic report,

and the budget message — talk bravely enough of the need for conserving money, materials, and energy for the defense effort. For example: "I should like to speak of the necessity of putting first things first . . . we must cut non-essential spending, both private and public . . . we must give up many of the things we can do without . . . we cannot have business as usual, consumer enjoyments as usual, or Government programs and services as usual" . . . etc.

At the same time we are told that —

This Government of ours — the Congress and the Executive — must keep on working to bring about a Fair Deal for all Americans. Some people will say that we haven't the time or the money this year for measures for the welfare of the people. But if we want to win the fight for peace, this is part of the job we cannot ignore.

Hence, we are going right ahead with "urgently needed" work to develop natural resources . . . we are going to keep on building "essential" highways . . . we must begin our "long-deferred" program of federal aid to education . . . we must train more doctors and other health personnel through aid to medical education . . . we must expand the basic public health services in our home communities . . . we must strengthen our system of farm price supports" . . . and so on.

Thus the impression is given that while the President wants to economize he is reluctant to do so at the expense of favored projects — a case of wanting to have one's cake and eat it too. With so much in the messages suggesting lack of firm purpose with respect to budgetary control, it is hardly surprising that estimated expenditures for fiscal '53 in the "all other" category come within $1 billion of fiscal '52 and are only $2 billion below fiscal '50, before the country had the expanded defense load to carry.

As for the three-fourths of total expenditures listed for "major national security programs," there is no warrant for the implication in the budget message that these are untouchable. Some, such as "promotion of defense production and economic stabilization", involve highly controversial items, and all need scrutiny from the standpoint of the amount of money asked and the effectiveness with which it is being used.

Defense Costs: Too Much, Too Soon?

In the search for further ways to cut the budget, attention naturally focuses on the $65 billion listed next year for national security programs. The basic question raised here is whether we are not attempting too much too soon. We are not in this case engaged in a short dash, in which we can go all-out and then rest up, but in a long race, in which we must set a pace that we can keep up.

People in Europe who do not share Washington's view as to the degree of urgency for pushing rearmament are resentful, both of the pressure from our Government upon them to rearm at the cost of depressing their living standards, and of the effects of our own arms effort in driving up world prices. Many American leaders recently have expressed their concern as to the consequences of such huge spending not only upon our own economy but also upon those of friendly nations throughout the world.

Former President Hoover has urged a reexamination of our whole foreign policy because of "the dangerous overstraining of our economy by our gigantic expenditures." Lewis Douglas, former Ambassador to Great Britain and now chairman of the Mutual Life Insurance Company, questioned in a recent address whether "in our anxiety to make ourselves invulnerable from without, we are making ourselves vulnerable to danger from within." He declared that:

The rearmament drive is producing painful strains on the economies of the Western World. In the United States, the cost of living has mounted to new high levels and the burden of taxation has soared to a grinding, painful and debilitating total. Abroad, the evidences of strain are even more striking. Much of the advance that has been made toward reconstruction through the Marshall Plan is, or so it appears to an ordinary citizen, now being lost. Bankruptcy, or impending bankruptcy, faces all governments.

One of the reasons why the defense expenditures are so large is the traditional rivalries of the various branches of the armed services to get their share of the funds available. While this was supposed to have been corrected by the unification program initiated several years ago, unification actually has been effective in only a limited degree. The result has been not only the cost to the taxpayer of untold millions of dollars in unnecessary outlays, but also, by virtue of this need for continual compromise in dividing up, the failure to get the maximum military effectiveness.

Another reason for swollen costs is the waste and extravagance in methods of operation that are repeatedly being revealed by Congressional committees. The Senate Preparedness subcommittee, headed by Senator Lyndon B. Johnson, and a similar subcommittee in the House headed by Representative J. Edward Hebert, have performed valuable public service in uncovering evidence of such shortcomings. The Senate subcommittee accused the Army of "inexcusable and indefensible waste" and found in all the services "unconcern with economy, an absence of genuine enthusiasm for efficiency, a widespread lack of

any real cost consciousness." Senator Paul H. Douglas, who has made a careful study of military expenditures, suggested that $7 billion could be cut from next year's total budget, of which $4 billion could come from proposed military expenditures "without reducing our firepower or effectiveness at all."

More Non-Defense Cuts Imperative

Because national security expenditures now comprise so large a proportion of the budget, there is frequently a tendency to minimize the amount of savings to be achieved through cutting non-defense costs. The fact is that these latter in next year's budget, as brought out earlier, exceed $20 billion – less than $1 billion below the current year and only $2 billion below 1950 before Korea. The President insists, as he has in the past, that non-defense costs have been cut to the bone. Actually, inspection of the budget message reveals many questionable items.

For example, the budget for next year includes funds for construction of three additional veterans' hospitals, notwithstanding that the present veterans' hospitals are only partly filled and that large additional capacity now under construction is nearing completion. Of the new patients admitted to the veterans' hospitals at the present time, only 12 per cent have ailments connected with their military service.

Although expenditures for flood control and reclamation are being cut back, those for the development of electric power are being expanded; altogether total expenditures for those purposes show a continued rise to over $1.2 billion for next year. Granted that there is need for more electric generating capacity, the taxpaying, investor-owned utilities, where ready and willing, should be permitted to provide it. Instead, the Federal Government is in some instances actually blocking the efforts of private utilities to build new power facilities and is insisting on carrying out, itself, the development with taxpayers' money.

The President lists nearly $300 million for agricultural price-support operations and "removal of surplus agricultural commodities" notwithstanding the concern over inflation, and the President asks the Congress to "strengthen our system of farm price supports". Presumably, this means lifting the support levels, although the American Farm Bureau Federation has declared, "We do not believe that action to raise the level of price support above that now provided in the Agricultural Act of 1949 is in the long-run interest of farm people."

Other items questionable under present conditions include the proposed outlays for rural electrification and rural telephones, public housing, federal aid to education, and the great variety of federal grants to states and municipalities for things that might better be taken care of at the local level, or, better still, that people might do for themselves.

A Test of Democracy

The budget which the President has presented places a heavy responsibility upon Congress. Faced with the prospect of a multi-billion dollar deficit, it has the usual alternatives of more taxes, reduced spending, and deficit financing, or some combination of the three. As a practical matter, however, the tax alternative is eliminated for the reason that the level of taxes is already too high. This leaves only the two choices – either the sound but hard way of reducing spending, or the dangerous but easy way of spending in excess of revenues and covering the difference by adding to the public debt.

In Congress the reaction to the budget message has been an unusually strong and widespread bipartisan demand that the $85 billion total be cut drastically. Among the Democratic majority, such key figures in Congressional money matters as Representative Clarence Cannon, chairman of the House Appropriations Committee, declared as an objective holding appropriations within the estimated receipts for fiscal '53, thus avoiding any further tax increases or any enlargement of the public debt. Representative Frederic R. Coudert, Jr., Republican, of New York, on the first day of the new session introduced into the House a resolution imposing for fiscal '53 a maximum ceiling on federal expenditures of $71 billion – the amount of tax receipts estimated for next year.

Whatever the method chosen, the objective of holding expenditures next year within estimated receipts at present tax rates is sound and urgently desirable. To reach such a goal will require courageous and determined action by Congress not only in curbing its own spending proclivities and those of the Administration, as reflected in new appropriations, but also in reviewing and modifying existing provisions of law as to mandatory, permanent, and carryover appropriations.

Possibly never before has the selection of the right budgetary course been more important to the future welfare of the country. In these issues we face a test of democracy and of the ability of the people, through their representatives in Congress, to exercise the restraint in their demands upon government that is necessary for

preserving the value of money itself. Such self-discipline is indeed the very essence of self-government.

Taxes and Inflation

Mr. Colin Clark, Director of the Queensland, Australia, Bureau of Industry, presented a theory six years ago that:

> . . . the level of budgetary expenditure acts, by a more or less automatic procedure, as the final determinant of the value of money, the cause taking perhaps two or three years to work out its full effect.

The theory has the ring of truth. Indeed, it is an age-old observation that when the sovereign makes extravagance his public policy money loses buying power for everybody.

Mr. Clark, an indefatigable statistician, attempted to find some particular point where, in modern experience, a rise of government outlays begins to hurt the value of money. He worked over expenditure figures of many countries for the period of the 1920's but ran into difficulties because of the confused state of the statistics. He shifted his attention to the figures on tax revenues, more easily available, and reached the conclusion that:

> 25 per cent of the national income is about the limit for taxation in any non-totalitarian community in times of peace.

What happens when this limit is exceeded? The economy may bog down into unemployment and depression under an excessive tax burden. But it is more likely, Mr. Clark holds, that "influential sections of the community become willing to support a depreciation of the value of money." In practical terms the government or central bank, to keep the economic machine going, pumps out more money.

This is a rather surprising theory. It has been generally believed that, while government deficits spell trouble, a balanced budget neutralizes the inflationary effects of a high scale of government expenditures. Certainly a balanced budget is a valuable safeguard. But, according to Clark's theory, even a balanced budget would spell trouble if taxation has to pass the critical limit in order to cover government outlays.

In an article which appeared in Harper's Magazine in December, 1950, Mr. Clark explained the matter as follows:

> We have learned, from the experience of many countries, what happens when taxes mount too high. Many people don't find it worth their while to work hard and efficiently. Production doesn't expand as fast as it should. There is a shortage of goods, followed by an inflationary rise in prices. The government then usually makes a counter-move – attempting by price controls, wage controls, and rationing to "suppress" the inflation that is developing, hoping that in due course production and the real national income will grow enough to carry the burden without controls. But this, experience shows, usually takes too long; and there is then a quick escape into uncontrolled inflation – which benefits some people, but does great harm to the great majority, including especially those lower-paid wage-earners who generally keep their savings in the form of money rather than real property.
>
> All this is familiar to us as a sequence of events that has been repeated over and over again in the experience of many countries. Yet the part that excessively high taxes play in causing inflation is still not fully appreciated. It is very widely understood that if a government incurs very heavy expenditures, and these are *not* covered by taxation, and the government runs at a deficit, the automatic result will be an inflationary trend. It is not so generally understood that if a government incurs very heavy expenditures, and these *are* covered by taxation, so that the budget is balanced, the trend – while it may be deflationary for a time–will in the long run be toward inflation if the rate of taxation is too high to be borne. 'The long run,' in this case, is probably a period of two or three years, though this may depend on the nature of the emergency; in wartime it may be longer.

The 1953 Budget and Clark's Theory

It is instructive to check the possible application of this theory to the federal tax revenues projected by the President for the 1953 fiscal year plus estimated State and local government revenues:

	Estimated Amount	Percentage of $282 billion national income	Percentage of $333 billion gross national product
Federal budget receipts*	$70 billion	24.8%	21.0%
Employment taxes	6 "	2.1	1.8
State & local government taxes	18 "	6.4	5.4
Total taxes	$94 billion	33.3%	28.2%

* Adjusted to exclude those employment taxes which flow into budget receipts.

The figures on national income, and the broader measure of gross national product (which many analysts prefer), are those given in the President's Annual Economic Report to the Congress as the rates prevailing in the fourth quarter of 1951. The official federal budget receipts figure, of $71 billion, is reduced in the table to $70 billion, to eliminate those employment (social security) taxes that are included in the budget receipts. The largest component of the employment tax figure, drawn from the President's budget, is the money that flows into the old-age and unemployment trust funds, not counted among budget receipts. The State and local government figure is an unofficial estimate of the current running rate of such taxes.

From the figures, which of course are all approximations, government at all levels is scheduled to take above 25 per cent of the gross national product and above 30 per cent of the national income at the fourth quarter 1951 rate.

Thus, on Mr. Clark's test, the percentages are waving the red flag of inflation ahead. So, too, are the President's messages to Congress. The Administration's recommendation, that Congress raise taxes still more, flies in face of the indication that we are already beyond the safe limit of taxation for peace-time, and that more taxes will create the need for higher prices, higher government spending, and more easy credit to keep the economy — and inflation — going full blast. This sort of thing, in past experience, ends in disaster.

There appears to be a considerable opposition to further tax increases in the Congress and attention is being given to curtailments of the swollen spending program to relieve the apparent need for tax increases. There are tremendous resources for financing defense in the United States, but there are limits in any country, no matter how wealthy, to what can be undertaken at one time. When we pass those limits we must look for trouble. Except as people can be induced to buy more government bonds and voluntarily to curb their expenditures, the primary attack has to be on the scale of government outlays. Indeed, this latter needs to be done to make government bonds an investment people can buy with security.

Inflation and Investments, 1939-51

An article in the December issue of this Letter on "Shrinkage of the Dollar" discussed the depreciation in purchasing power of money that has been experienced, here and abroad, and the government policies that have been held responsible for that depreciation. One of the many inequities of inflation, and one which continues to cause particular concern here, is its effect in destroying the real value of people's investments built up through years of working and saving.

The tables presented later in this article are designed to illustrate in very general terms what happened to various types of investments from the middle of 1939 (prior to the outbreak of World War II) up to the end of 1951. Quotations are included for typical bonds, stocks, commodities, and real estate, as well as for money held in cash or in a savings account.

During that period the level of consumer prices or cost of living in the United States rose by 90 per cent. Putting it another way, the purchasing power of the dollar declined by 47 per cent, and the December 1951 dollar therefore was worth only 53 per cent of the 1939 dollar. The tables show changes in principal and income over the period, measured both in current dollars and in dollars of 1939 buying power. The calculated changes are determined largely by the particular dates selected for the comparison and the results would of course be different in other periods.

Loss on Cash

Cash held throughout the 12½-year period ended December 1951 fell in value at the same rate as purchasing power or by 47 per cent, representing a loss of 5 per cent a year, compounded. A savings bank account would, like cash, have depreciated in real value by 47 per cent. The prevailing interest rate paid in New York on such accounts has been raised from 1½ to 2 per cent but the purchasing power of the income has fallen by 29 per cent.

In this connection, some of our readers have inquired as to how the old U.S. dollar has held up. Americans, of course, were required to turn their gold coins over to the Treasury in 1933 and, except among coin collectors, no domestic market exists for such coins. Abroad people are generally free to acquire and hold gold, and in Paris recently the $10 gold "eagle" has traded at $24 in U.S. money. Any foreigner who has held U.S. gold coin since 1933, when the dollar was depreciated, has lost nothing in terms of capacity to buy American goods or services.

Changes in the Nominal Value of Various Types of Investments, 1939-51, in Current Dollars and in Dollars of 1939 Purchasing Power

	Nominal Value June 30, 1939	Nominal Value Dec. 31, 1951	% Change in Nominal Value 1939-51	% Change in 1939 Dollars
Cash				
Cash	$100.00	$100.00	—	— 47%
Savings bank account	100.00	100.00	—	— 47
Bonds				
U.S. Treasury 2¾s of 12/15/60-65	107.00	109.25	+ 2	— 46
New York City 4s of 10/1/80	116.75	124.50	+ 7	— 43
State of New York 4s of 1/1/67	137.12	130.37	— 5	— 50
Atchison, T. & S.F. 4s of 10/1/95	109.50	118.00	+ 8	— 43
Sou. Bell Tel. & Tel. 3s of 7/1/79	107.50	97.75	— 9	— 52
Public Ser. El. & Gas 3¼s of 7/1/68	110.00	100.62	— 9	— 52
National Steel 3s of 4/1/65	101.50	102.75	+ 1	— 46
Preferred Stock—Average				
Standard & Poor's	159.80	161.90	+ 1	— 46
Common Stocks—Averages				
Railroads—Dow Jones	25.85	81.70	+216	+ 68
Industrials—Dow Jones	130.63	269.23	+106	+ 9
Public utilities — Dow Jones	22.97	47.22	+106	+ 9
Fire insurance—Standard & Poor's	100.90	188.10	+ 86	— 1
New York banks — Standard & Poor's	89.90	112.20	+ 25	— 34
Real Estate				
1-Family houses, Washington, D. C.	$6,280	$15,833	+152	+ 34
Farm real estate—Dept. of Agr. index	84	206	+145	+ 30

Bonds Versus Equities

The investor who has held high-grade bonds, unlike the holder of cash, has had an investment of fluctuating market value. Generally bond prices decline in periods of inflation but in this period bonds have benefited price-wise from the artificial cheap money policy pursued by the Government. These benefits have provided small comfort to the bond investor; the policies that have supported nominal bond prices have helped to reduce the value of the bondholder's invested dollar 47 per cent since 1939. The preferred stock holder has been in the same boat. As the table suggests, market price fluctuations have had only a minor influence on the experience of holders of high-grade bonds and preferred stocks. Most important has been the shrinkage in the real value of the investment.

The owner of property, or equities in property, typically has fared much better than the bondholder. Since market prices fluctuate more widely the results would vary depending on the period chosen for the comparison, not to mention the particular investment held. For the June 30, 1939 to December 31, 1951 period, used in the table, the best record for any class of stocks was scored by railway shares, the poorest by bank shares.

The nominal gains, of course, properly should be measured not only against the loss in the value of the dollar, but also with reference to the capital gains tax, a maximum rate of 25 per cent* applying on any very large sum. To allow for this tax, a person who sold out in December 1951 an asset acquired in June 1939 would have had to realize a capital gain of 120 per cent to come out, after tax, with the 90 per cent gain needed to compensate for the diminished value of the dollar received in payment. The more fortunate or skillful holders of common stock have had gains of this degree or greater. Likewise many farmers and home-owners have seen the dollar values of their real property keep ahead of inflation, even after allowance for the capital gains tax that would have to be paid if the gain were realized.

Income From Investments

It is pertinent also to note what has happened to income on investments. The holder of short-term bonds in June 1939 generally experienced a falling income, lately followed by a partial recovery. How he has come out would depend on when his bonds matured and what he took in replacement. The person who has held long-term bonds throughout the period has seen the real value of his constant income drop by 47 per cent, and the preferred stock holder has had the same experience.

Common stock investments, of course, have done a great deal better. Railroads, many on a non-dividend-paying basis in 1939, led the others with increased dividend payments. Besides railroads, many industrial companies increased dividend payments to the shareholder more than the 90 per cent required to keep even with the inflation of consumers' goods prices. Shareholders of banks fell behind although they generally fared better than the average bondholder or preferred stockholder. Most landlords, under rent ceilings, were in the class of bank shareholders, at least in terms of their gross rental incomes. Farm incomes, again on a gross basis, rose more than any other class of property income. Indeed, increase in agricultural prices, encouraged by government policy, was a prime factor in the rise of the cost of living experienced by everyone.

Changes in the Rate of Income from Various Types of Investments, 1939-51, in Current Dollars and in Dollars of 1939 Purchasing Power

	Dollar Rate of Inc. June 30, 1939	Dollar Rate of Inc. Dec. 31, 1951	% Change in Dollar Rate of Income	% Change in Terms of 1939 Dollars
Bonds				
U.S. Treasury 2¾s of 12/15/60-65	$2.75	$2.75	—	— 47%
New York City 4s of 10/1/80	4.00	4.00	—	— 47
State of New York 4s of 1/1/67	4.00	4.00	—	— 47
Atchison T. & S.F. gen. 4s of 10/1/95	4.00	4.00	—	— 47
Sou. Bell Tel. & Tel. 3s of 7/1/79	3.00	3.00	—	— 47
Public Ser. El. & Gas. 3¼s of 7/1/68	3.25	3.25	—	— 47
National Steel 3s of 4/1/65	3.00	3.00	—	— 47
Preferred Stocks—Average				
Standard & Poor's	7.00	7.00	—	— 47
Common Stocks—Averages				
Railroads—Dow Jones	1.48	4.90	+231	+ 75
Industrials—Dow Jones	6.11	16.33	+167	+ 42
Public utilities — Dow Jones	1.23	2.51	+104	+ 8
Fire Insurance — Standard & Poor's	4.27	7.15	+ 67	— 11
New York banks — Standard & Poor's	4.41	5.27	+ 20	— 37
Real Estate				
Rents—Bureau of Labor index	104.3	139.2	+ 33	— 29
Gross cash income per farm	$1,378	$6,151	+346	+137

Calculations of increases of income, in relationship with price inflation, must also reckon with the personal income tax. Any considerable increase in income results in a more than proportionate increase in income tax because of the progressive character of the rate schedule. When further account is taken of the radical increases in the tax rate schedule since 1939 many people have found that even if income before tax has

* Raised to 26 per cent for 1952. In 1951 the tax on long-term capital gains ranged from 10.2 per cent to 25 per cent.

more than kept pace with price increases, income after tax has not. The income tax schedule for 1952 is even higher than that of 1951.

In a recent article in the U.S. News & World Report on the extent to which inflation and taxes together have impaired the living standards of various income groups, a table was given comparing the income in 1939 of families (married couple and two children) with the income that they must get to live as well in 1952. The increases that would be required were, in typical cases, from $1,200 to $2,252, from $2,500 to $5,347, from $5,000 to $11,480, from $10,000 to $25,224, and from $25,000 to $94,356.

Commodities

For hedges against inflation some turn to commodity speculation. Warehousing of bulk commodities is not a practical enterprise for most people, and dealings in "futures" markets for cotton, wheat, etc., are short-term speculative, rather than long-term investment, undertakings. Nevertheless, it is pertinent to observe the increases in some of the leading commodities from June 1939 to December 1951:

Changes in the Prices of Basic Commodities, 1939-51

	June 30, 1939	Dec. 31, 1951	Per Cent Change
Cocoa, lb.	0.044	0.32	+627
Corn, bu.	0.49	1.96	+300
Cotton, lb.	0.094	0.42	+347
Wheat, bu.	0.72	2.50	+247
Wool, lb.	0.70	1.85	+164
Rubber, lb.	0.164	0.52	+217
Copper, lb.	0.10	0.245	+145
Platinum, oz.	33.50	90.00	+169
Silver, oz.	0.38	0.88	+132
Tin, lb.	0.49	1.03	+110

A Summary

There can be little question that, in this 12½-year period of inflation, some people have defended themselves successfully against inflation, and even accumulated small fortunes in legitimate speculation in commodities, common stocks, or real estate equities. Generally such people correctly assayed not only the war climate in 1939, but also the inflationary policies that the Government had undertaken in devaluing the dollar in 1934 and putting government expenditures up to new peaks as a formula for prosperity through chronic inflation.

But generally these people had, over and above a correct appraisal of the situation, qualities of expertness in particular markets, substantial capital, and willingness to risk losses. For great numbers of people these opportunities are foreclosed. A small capital, a reserve for family emergencies or children's education, should not go into speculative uses. The poorer a person, the less informed on market techniques, the greater disadvantage he has been under in protecting himself and the more vulnerable he is to losses in the real value of his savings from a corruption of the currency.

Savings Bonds

In this connection, a good deal of publicity has been given to the losses in purchasing power to the Savings bond holder. For example, three $25-denomination Series "D" Savings bonds (predecessor to the Series E) acquired in June 1939 for $56.25, came due in June 1949. If the $75 proceeds had been reinvested in four $25-denomination Series "E" bonds, the latter in December 1951 would have had a redemption value of $77. This is 37 per cent more than the $56.25 the citizen invested 12½ years before. But the $77 will buy, in consumers' goods, 27 per cent less than the $56.25 would have bought in 1939. The shrinkage of the dollar has become a matter of commonplace observation. It has visibly tended to slow new sales of Savings bonds to a point where they have been running short of the amounts being redeemed. To restore Savings bonds to their former prestige two courses are necessary: first, to improve rates offered; and, secondly, to restrain the government spending and taxing that erodes the value of the invested dollar.

Subject to Many Qualifications

The highly uneven changes among the different types of investments selected as illustrations are necessarily theoretical and subject to many qualifications. Limiting the price comparison to only two dates, June 30, 1939 and December 31, 1951, overlooks many intermediate price fluctuations of importance, as well as the fact that certain prices were somewhat out of line on the earlier date used as a base in computing the percentage changes.

Income in the form of capital gains may be much more valuable than the same amount of interest or dividends to certain investors, because of the lower rate of federal income tax applied. Profits realized on the sale of capital assets held over six months are subject in 1952 to a maximum tax of 26 per cent, in contrast with the regular income rates which are 29 per cent in the bracket above $4,000 and rise to 92 per cent on income over $200,000.

No Guide to the Future

The experience in these various types of investments during the past 12½ years is not, of course, a guide as to what is likely to happen during the coming years. Even though the future might bring further inflation, it still does

not follow that such inflation would have exactly the same pattern. The chief lesson of inflation, indeed, resides in the fact that there exists no practical substitute for sound money in an ordered and equitable society.

Increased Meat Production Needed

Because of the importance of meat in the diet and in the family budget, the prices at which meat is selling are the symbol of high living costs for the American consumer. But though people may object vigorously to rising prices of meat, few will do without it unless they cannot afford it. A healthy nation needs proteins, vitamins and minerals and, for most Americans, meat seems to be one of the most appetizing ways of providing them.

In this country there has been a long-range shift, dating back to pre-World War I days, to the higher grade, health-protecting foods such as meat, milk, eggs, green leafy vegetables, and fruits, at the expense of fats and such carbohydrates as white bread and potatoes. This has been a part of the rising standard of living. Dean William I. Myers of the New York State College of Agriculture at Cornell University estimates that the improvement in per capita diet, including both quality and quantity, amounted to about 16 per cent during the 10-year period ending 1947. Along with the accelerated rise in population, which in the past 15 years has brought 30 million new consumers into the markets, this rising dietary standard has profoundly influenced the demand for American farm products.

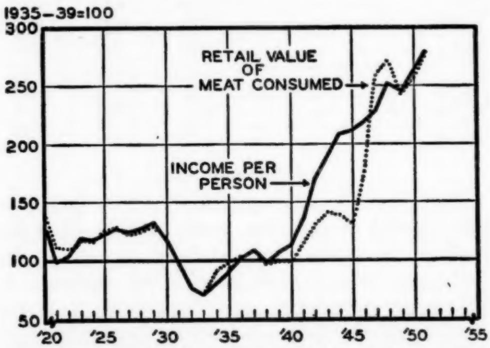
The shift of demand to higher quality foods has been intensified by the expansion of spendable incomes during the rearmament boom. The recent picture is one of "shortages" of these foods, relative to what consumers with greatly increased incomes are able and willing to buy.

The Demand and Supply of Meat

The impact of rising consumer demand has been felt particularly by the meat industry, principally because an increase in livestock output is a relatively slow process. The first effect of rising incomes was a slowing down of meat production, especially beef, because growers began to withhold breeding stock from slaughter in order to build up their herds. Per capita consumption of red meat – which is roughly the same as per capita production – rose from 126 pounds a year in the 1935-39 period to 155 pounds in 1947, nearly 25 per cent. It then declined to an estimated 141 pounds in 1951. Most of this decline took place in beef.

Prewar (1935-39) consumption of beef was about 55 pounds per person; it rose to a postwar peak of 69 pounds in 1947, but declined to 58 pounds in 1951. This year the cattle inventory should provide, according to the Department of Agriculture, about 10 per cent more, or about 64 pounds. It will be more if the feed grain supply situation tightens and the fattening of range cattle in the feed lots becomes less profitable; it will be less if cattle feeding is disrupted again by price-control uncertainties as it was last year, and cattle growers decide to make another substantial addition to their herds.

Evidently the market could absorb much more than last year's estimated production of about 9¼ billion pounds of beef. Government figures show that over a period of several decades between 5½ and 6 per cent of disposable income has been spent for meat. Since 1937, per capita disposable income increased somewhat more than 2½ times, and, as will be seen from the chart below, a close and fairly stable relationship has existed between disposable income and retail value of meat consumed. The exception was the war years when rationing and price ceilings interfered.



Meat and Income: Indexes of Retail Value of Consumption and Income, per Person. 1935-39 Average = 100. Source: U. S. Department of Agriculture.

People are willing to buy large quantities of red meat even when on a calorie basis other types of protein foods such as poultry, eggs, fish, and cheese are less expensive. To keep living costs down more livestock production is needed. That is what the high prices are telling us.

Favored Position of Livestock Industry

Although the high retail prices of meat have not been fully reflected in farm prices of meat animals, prices of the latter have compared favorably during recent years with prices received by farmers for other products. Beef

cattle in particular, to quote Charles E. Burmeister formerly of the Department of Agriculture, "occupy the most favored position in our livestock economy today. They have held this position for the last 10 years, and more recently the beef industry has been about the most favored enterprise in all agriculture."

Despite this situation, the cattle industry has lagged behind population growth. As late as 1949, when cattle and calves on farms numbered about 78 million, livestock *per capita* approached an all time low. Since then, cattle herds have been rebuilt to an estimated 89 million head as of January 1, 1952. This is an all-time record insofar as cattle numbers go, but in relation to population the numbers are no larger than in the 1935-39 period when the disposable income per person was an estimated $510 as against $1,450 in 1951.

Moreover, the very process of expanding herds in 1951 resulted in some 6 million head – the largest number on record in any one year – being held off the market. This was about one-sixth of the current production. In 1947, when beef consumption reached a postwar high, some 36 million head were slaughtered, with 81 million cattle and calves reported on farms. In 1951, slaughter was down to about 28 million head, the smallest in 10 years for cattle, and, because of herd building, the smallest in 18 years for calves. The confused feeding situation brought about by the scheduled price rollbacks contributed to the sharp curtailment in last year's marketing.

Higher Prices Stimulus To Production

With larger supplies there may be a moderate decline in beef prices this year despite another increase in disposable income. But prices of beef – and meat in general – will have to stay high if supplies of meat and other higher quality foods are to expand, as is essential over a period of years.

The phenomenal growth of our population during the past decade has forced upward revision of consumption estimates for many commodities. In view of this and the expansion of spendable incomes, 100 million head of cattle – a number toward which we are well on our way – does not seem excessive provided the livestock industry can feed that many animals without increasing costs too much. To keep down costs the livestock producers must find ways to increase further (1) the animal carrying capacity of the land, and (2) the production efficiency of their animals.

To increase the animal carrying capacity of the land, more improved pasture land is needed. It was claimed at the recent meeting of the American Association for the Advancement of Science that there is enough grassland and abandoned and submarginal land in the humid areas east of the Plains to produce, if properly handled, an additional 10 to 15 million tons of beef annually. Grassland and cattle raising are especially suited to humid areas, and many a farmer could solve some of his problems by putting more of his land into grass.

The livestock industry has done a great deal since the lean days of the depression in improving the production efficiency of animals. Cattle are marketed at lighter weights, which means more pounds of meat per unit of feed, and herds are constantly improved by use of better sires. The great technological advances can be better applied, however, in the raising of the feed and forage which the livestock industry converts into higher quality, more desirable foods. Low cost livestock production, therefore, is dependent on reasonably priced feed and on more efficient and expanded output of feed grains, such as corn, oats, and such high protein feeds as soybean and cottonseed cake.

However, there are obstacles to be hurdled if the country is to keep down the cost of carrying more meat animals. One is the government policy of supporting feed grain prices at a high level, a policy which some farm leaders are now beginning to deprecate. If the feed surpluses during the 1948-50 period had been allowed to come on the market as cheap feed instead of being stored in government bins, more meat animals would have been produced and slaughtered and consumers would have had cheaper meat. If it were not for government planning and price-fixing on meat last year, more meat would have been available.

For two decades the threat of farm surpluses has dominated most of our farm legislation. But in the same period the market has been growing as a result of expansion of our population and gains in per capita income and food consumption. Considering food shortages abroad, the situation calls for a new analysis of agricultural policy. The world needs more food in general. We, in this country need more higher grade protein foods, and especially more meat.

U.S.A.